Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Johnson	Analyst:	Roger Lackey	Bill Number:	SB 376
Related Bills:	See Legislative History	Telephone:	845-3627	Introduced Date:	02-21-2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Minimum Franchise Tax Reduction For All Qualified New Corporations Subject To Annual Tax

SUMMARY

This bill would reduce the minimum franchise tax or annual tax to $500 for all business entities.

PURPOSE OF THE BILL

The author's staff has indicated that the purpose of the bill is to eliminate the minimum franchise tax or annual tax for the taxpayer's first taxable year. Currently, the bill would not accomplish the author's intent.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. It would apply to taxable years beginning on or after January 1, 2001.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist the author in resolving the implementation considerations discussed below.

ANALYSIS

FEDERAL/STATE LAW

Existing State law provides that every corporation incorporated in this State, qualified to transact intrastate business in this State, or doing business in this State is subject to the franchise tax in an amount not less than the minimum franchise tax. Liability for the franchise tax begins on the earlier of the date of incorporation, qualification, or commencing to do business within this State. The yearly obligation to pay the franchise tax ends on the effective date of dissolution or withdrawal or, if later, the date the corporation ceases to do business within the State.

Board Position:			Department Director	Date
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Beginning January 1, 2000, all corporations that are newly incorporated or newly qualified to transact business in this State are exempted from the minimum franchise tax for their first and second taxable years. Thus, they are not required to prepay these amounts to the Secretary of State (SOS) with their incorporation papers. <u>The exemption only applies to corporations.</u>

Existing state law provides that real estate mortgage investment conduits (REMICs) are subject to and required to pay the minimum franchise tax. Regulated investment companies (RICs) and real estate investment trusts (REITs) organized as corporations also are subject to and required to pay the minimum franchise tax.

Further, **existing state law** provides that every limited partnership (LP), limited liability partnership (LLP), and limited liability company (LLC) registered in this State, qualified to transact intrastate business in this State, or doing business in this State is subject to an annual tax equal to the minimum franchise tax. Liability for the annual tax begins on the date of registration with the SOS, qualification, or commencing to do business within this State. The obligation to pay the annual tax ends on the effective date of cancellation of the entity or the date the entity ceases to do business in the State.

In addition, for taxable years beginning on or after January 1, 1999, and before January 1, 2000, **State law** provided that the prepayment to the SOS for the first taxable year of a "qualified new corporation" is $300, and the minimum franchise tax for its second taxable year is $500. For each taxable year thereafter, the minimum franchise tax is $800. A "qualified new corporation" does not include any corporation that began business operations as a sole proprietorship, a partnership, or any other form of business entity prior to its incorporation. To be eligible for the reduced prepayment and minimum franchise tax, the qualified new corporation must have been incorporated on or after January 1, 1999, and before January 1, 2000, and have gross receipts of $1 million or less.

<u>THIS BILL</u>

This bill would amend the $500 reduced minimum franchise tax for "qualified new corporations" to delete language that made the provisions inapplicable to LPs, LLPs, LLCs, REMICs, RIC, and REITS. **However, it should be noted that the $500 reduced minimum franchise tax only applied to taxable years beginning on or after January 1, 1999, and before January 1, 2000.**

<u>IMPLEMENTATION CONSIDERATIONS</u>

This bill as currently drafted would not provide the intended benefit to the business entities. The provisions amended address the minimum franchise tax for taxable years beginning on or after January 1, 1999, and before January 1, 2000. However, the bill is effective and operative for taxable years beginning on or after January 1,2001. In addition, the bill does not alter provisions of existing law that identify an annual tax by reference to the unreduced minimum franchise tax.

If the bill were amended to provide relief from the minimum franchise tax or the annual tax and made retroactive for 1999 and 2000, business entities would be able to file amended returns for the respective taxable year to claim refunds of the minimum franchise tax or annual tax paid. As a result, the department would receive an increase in the number of amended returns filed and the subsequent refunds issued. In addition, such treatment would likely be considered a gift of public funds and, in the absence of a public purpose, would raise certain constitutional issues.

If it is the author's intent to provide these business entities the same exemption from the minimum franchise tax received by corporations that incorporated on or after January 1, 2000, additional amendments would be necessary.

LEGISLATIVE HISTORY

AB 10 (Correa, Stats. 1999, Ch. 64) exempted every corporation that incorporates or qualifies to do business in California on or after January 1, 2000, from the minimum franchise tax prepaid to the SOS for its first taxable year and the minimum franchise tax for the second taxable year.

AB 1843 (Ackerman, Stats. 2000, Ch. 862) eliminated the term and concept of income year and revised the exemption from the minimum franchise tax to only the first taxable year.

OTHER STATES' INFORMATION

The following states were chosen because their income tax system is similar to California's.

Florida: No minimum franchise tax or other similar tax or fee.

Illinois: Annual franchise tax based on paid in capital. The tax can range from a minimum of $25 to a maximum of $1 million.

Massachusetts: Minimum franchise tax equal to $456.

Michigan: Franchise tax for the right to do business. The tax is 2.3% of the adjusted tax base.

Minnesota: Minimum fee determined by property, payroll, and sales in the state. The fee can range from $0 to $5,000.

New York: Fixed dollar minimum tax based on gross payroll. The tax can range from $100 to $1,500. However, if a corporation either has total receipts or the average value of gross assets less than $1,000, the tax amount is fixed at $800.

FISCAL IMPACT

Once the implementation considerations are resolved, this bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

For the purpose of this revenue estimate, **this analysis is based on the author's intent and not as written**. Based on the data and assumptions below, revenue losses are estimated as follows:

Estimated Revenue Impact*			
Taxable Years Beginning On or After January 1, 2001			
Enactment Assumed After June 30, 2001			
Fiscal Years			
(In Millions)			
	2001-2	2002-3	2003-4
Reduced Minimum Franchise Tax	-$15.0	-$6.5	-$7.0

- Rounded to the nearest $.5 million.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The impact of this bill would depend on the number of specified entities incorporating or qualifying to do business in California and the amount of any measured tax generated in lieu of the eliminated first year annual tax and minimum franchise tax.

It is projected that for 2001 there will be approximately 13,000 new entities that will benefit from eliminating the first year minimum tax as proposed. These estimated losses are based on an estimated growth rate of 5 percent per year for all entities other than limited liability companies (LLCs). The growth rate for LLCs is based on specific LLC departmental projections and varies in each year.

The projected loss for 2001-02 includes 2001 LLC minimum tax payments that would have to be refunded in 2001-02 if the proposal is enacted. Under current law LLC minimum tax payments are payable on or before the 15th day of the fourth month of the taxable year.

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